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C O N F I D E N T I A L SECTION 01 OF 02 RANGOON 001557

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SUBJECT: BURMA: BANKS AND CONSTRUCTION BOOMS, A BAD MIX

Classified By: COM CARMEN MARTINEZ FOR REASONS 1.5 (B,D)

11. (C) Summary: The puzzling construction boom, continuing in Rangoon despite the dismal economy and an unclear demand, is being fueled by speculation by builders and investors. Unfortunately for the economy, private banks have not learned the lessons of Japan and are throwing caution to the wind in their financing of economically questionable construction projects. With their loan portfolios already grim, many of these private banks could be wiped from the map if and when the Central Bank ever takes steps to bring credit under control. End summary.

Paving Paradise

12. (SBU) Even in the midst of the country's economic crisis, the construction industry in Rangoon is still relatively active. The newspapers regularly report on shining new office or apartment complexes, and bamboo scaffolding is evident on every block. Part of the SPDC's drive to have a "modern and developed" city is to make prime land readily available for development. These plots, owned either by the Office of the Prime Minister's Yangon City Development Council (YCDC) or the Department of Construction's Human Settlement and Housing Development department, are put out for bid. Interested construction companies (or consortia) negotiate with the owner for the right to build. The firms offer the respective government agency an equity share (usually 30-50 percent of the space) in exchange for a renewable 60-year lease. The winning firm need not make any official payments to the government in exchange for the construction rights. However, informal payments and close connections with key government officials, especially Secretary-1 General Khin Nyunt, are invaluable.

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13. (SBU) Many of the largest construction firms are part of keiretsu-style integrated holding companies that include a major private bank. In addition, lending rates, set nationally by the Central Bank of Myanmar are about 15 percent -- well below annual inflation rates. Thus it is not surprising that construction firms rely largely on bank financing for their projects. Financing is possible through the pre-sale of apartments and office space. Banks assist in this as well by offering generous loans to potential renters/buyers.

If You Build It, Will They Come?

14. (SBU) Members of the country's largest construction industry association told us that business is good because demand for new housing and office space continues to be very high. They asserted that rapid construction of new apartments is being pushed forward by Rangoon's population growth. (Note: This seems unlikely as the vast majority of Rangoonites cannot afford the luxury apartments or offices constructed by these firms.) The builders said that in addition, wealthy business people and high-ranking officers are buying many of the new apartments, condos, and offices as a hedge against a plummeting kyat.

15. (SBU) There is no question that real estate is now viewed as the hedge of choice in an economy where anyone who can afford to keeps their kyat holdings low. However, it seems unlikely that the minuscule upper class (even purchasing two or more units as pure investments) could support ongoing and planned construction. An independent economist following the construction sector said that construction firms are also speculating, taking out cheap kyat loans and putting the money into something more solid, even without reliable demand projections. Also, he noted, these construction firms were taking their time in building, trying to whip up demand for their "exclusive" properties along the way.

Banks Rolling the Dice

16. (SBU) As long as the government is eager to develop prime downtown locations, construction firms can get unlimited cheap loans, the kyat continues its decline, and the Rangoon

glitterati view real estate as a solid investment, the construction bubble should continue to inflate despite the economy's problems. However, the participation in this boom of many of the nation's private banks could be edging them toward a Japan-style banking crisis. All the signs are there: an industry building excessively expecting the market to remain high, unfettered bank lending to companies based on personal connections rather than objective analysis of future income potential, and collateral in real assets priced at their inflated value. The private banks here already suffer from poor management, high reserve requirements, irrational government-set lending and deposit rates, and high non-performing loan portfolios. A fall in real estate prices, or a credit crunch imposed by the Central Bank, could quickly ruin these banks by dumping on them an immense additional burden of bad debt.

17. (C) Comment: The question, then, is not whether the private banks that binged on real estate will collapse, but what the impact of their collapse will be. The immediate impact on society will not be great. Certainly the construction industry and a few other sectors dominated by private firms will suffer from a reduction in their free-flowing capital. However, the formal private banking sector in Burma is still small relative to the entire economy. Most individuals and most businesses will get by, as they do now, without significant bank loans or deposits. Few would suffer if some private banks went bad. Longer term, though, the effects would be more pronounced, particularly if the Central Bank bails out failed banks by essentially printing money. The net result then could be a de facto mass nationalization of the banks and another huge setback for hopes of financial and economic reform. End comment.
Martinez